

Winning Letter

A bowl of credit crunch anyone?

In much the same way that retailers rush to assure consumers of the quality of their products following a food scare, credit lenders are currently trying to convince investors of the quality of their assets following the US subprime mortgage crisis. Though the outlook may appear bleak, investor confidence can be re-established in part by simply providing a clearer view of risk and the way assets are priced by reviewing the origination process and risk models. As with many crises, be they food or finance, the key to a quick resolution often lies in transparency and audibility.

Thanks to the rise of the celebrity chef and greater health awareness, ignorance of the ingredients and source of our food is no longer palatable. Similarly, investors now want to be provided with more information on the ingredients of their credit portfolio through an independent evaluation on the risk profile of the underlying assets they are purchasing. This visibility applies not only to how portfolios are built, but also to which strategies have been chosen to hedge risk. Arguably, through this revised approach, when the crisis next occurs - as it inevitably will - it will be easy to identify and isolate the specific instruments affected and should therefore not jeopardise overall market confidence.

The financial market now needs to raise the bar by developing new models to better understand the effect of liquidity risk on the pricing of otherwise low-risk instruments. It is in this scenario where technology arguably has a role to play. As an advocate of flexible decision automation, technology such as

Business Rule Management Systems (BRMS) which assist credit institutions and banks in many aspects of the underwriting and distributing credit processes, are crucial in the drive for transparency. BRMS facilitates portfolio managers and credit professionals in enhancing their operational efficiencies, optimising processes and managing risk and value along the entire securitisation supply chain.

A decision-led approach allows managers to automate portfolio regulatory policies and guidelines alongside best practices and their individual and corporate intellectual property. And in so doing, managers can develop extensive internal and external ratings, profiles and risk analysis systems - not only providing transparency for existing customers, but also for future potential investors.

The US subprime mortgage crisis, like a major Salmonella outbreak, has caused a significant dip of confidence in the product and rightly prompted investors to question portfolios and the specific risk of underlying assets. Portfolio managers must now prove that they are successfully managing and balancing risk exposure within their portfolios if they want to regain some of the confidence lost.

Appropriate technology solutions hold the key to standing up to this level of scrutiny and providing the visibility of underlying assets needed to continue to operate confidently in an uncertain market. Re-establishing confidence in the financial marketplace will take some effort and change in behaviour, but if investors are as resilient as consumers, then it shouldn't be too long before trust is restored.

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